No. 17-961

IN THE

Supreme Court of the United States

THEODORE H. FRANK and MELISSA ANN HOLYOAK,

Petitioners,

v.

PALOMA GAOS, on behalf of herself and all others similarly situated, et al.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE CATO INSTITUTE AND AMERICANS FOR PROSPERITY AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Federal Rule of Civil Procedure 23(e)(2) requires that a settlement that binds class members be "fair, reasonable, and adequate." Here, the Ninth Circuit upheld approval of a settlement that disposed of absentee class members' claims while providing those class members no relief at all. Breaking with the Second, Third, Fifth, Seventh, and Eighth Circuits, the Ninth Circuit held that the settlement's award of $5.3 million to six organizations that had prior relationships with class counsel and/or defendants was a fair and adequate remedy under the trust-law doctrine of *cy pres*. The question presented is:

Whether the Fifth Amendment's Due Process Clause, the First Amendment's Free Speech Clause, and Rule 23(e)(2) require courts to reject proposed *cy pres* class action settlements that deprive class members of their legal remedies and compel speech approved of by class counsel, defendants, and the court without meaningful consent by class members.

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute was established in 1977 as a nonpartisan public-policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies was established in 1989 to help restore the principles of constitutional government that are the foundation of liberty. Toward those ends, the Cato Institute publishes books, studies, and the *Cato Supreme Court Review*, and conducts conferences and forums.

Americans for Prosperity ("AFP") exists to recruit, educate, and mobilize citizens to promote a free society, helping every American live their dream—especially the least fortunate. AFP's 3.2 million activists nationwide promote limited and accountable government, lower taxes, and more freedom.

This case concerns *amici* because the ruling below undermines the basic ideas that government may not take citizens' property without due process or to compel them to fund speech with which they disagree. It is also a threat to the integrity of the adversarial legal system and thus to constitutional due process.

SUMMARY OF ARGUMENT

The use of *cy pres* awards in class-action settlements violates the constitutional rights of absent class members. Specifically, the Fifth Amendment's Due Process Clause protects class

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[1] Rule 37 Statement: All parties were timely notified of and have consented to the filing of this brief. Further, no party's counsel authored this brief in whole or in part and that no person or entity other than *amicus* funded its preparation or submission.

members' right both to adequate representation and to pursue their legal claims against the defendant, while the First Amendment's Free Speech Clause protects the right of class members to be free from compelled speech—including being forced to fund charitable organizations to which class members might be opposed.

The Constitution protects the right to property, including the legal right to seek redress through the courts. At the very least, that right includes the legal claim, itself, and the amount of the judgment attributable to the injury giving rise to the claim. Those rights are the personal property of individual plaintiffs, and class members are guaranteed due process through adequate representation in pursuing their claims. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985). The aggregate nature of class action lawsuits inherently interferes with the individual nature of class members' rights, but wrongs against class members may remain unredressed without the class action mechanism. In order to achieve balance and maintain due process for class members in the protection of their individual rights, the law permits class actions but the Constitution requires courts to engage in a "rigorous analysis" under Rule 23. *Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541, 2552 (2011).

The opt-out default mechanism for class formation creates a greater need for judicial oversight than do most procedural rules because it creates perverse incentives. Allowing class counsel to generate a class without affirmative consent from class members

involuntarily transfers individual rights to counsel's control, who have no incentive to safeguard individual property rights. Instead, class counsel have strong incentives to enrich themselves at the expense of absent class members, engaging in self-dealing and collusion with defendants.

Introducing *cy pres* awards into class actions makes things even worse. *Cy pres* awards take property from class members, transform it into monetary value, and then give it to someone else, all without the meaningful consent of the property owners. Moreover, *cy pres* awards—particularly *cy pres* only settlements—allow class counsel and defendants to appear publicly charitable with money that rightfully belongs to the class. Cy *pres* awards effectively reduce defendants' cost of settling and increase class counsel's total compensation by operating as near-perfect substitutes for existing or planned charitable giving. Even more troubling, *cy pres* settlements threaten the judiciary's neutrality, as awards can be tailored in an attempt to curry favor with the judges who must approve settlements.

Notwithstanding due process concerns, *cy pres* might be justified if necessary to preserve and defend class members' individual rights, but that is not the outcome of most class action settlements, especially *cy pres*-only settlements. Instead, class counsel and defendants further their self-interest through rent-seeking that has been rejected in other contexts. Deterring wrongful future behavior is a legitimate concern, but one separate from protecting property rights, which the Due Process Clause requires.

When the judiciary fails to provide meaningful oversight of the class action settlement process, it shares some responsibility for the deprivation of each class member's Due Process rights. The judiciary also shares some responsibility for the deprivation of class members' First Amendment rights when a court approves a *cy pres* award as part of a class action settlement, because it forces class members to "endorse[] . . . ideas that [the court] approves." *Knox v. SEIU, Local 1000*, 132 S. Ct. 2277, 2288 (2012). The opt-out system used in the class-action context is problematic because it presumes "acquiescence in the loss of [the] fundamental right" to be free from compelled speech and places the burden on absent class members. *Id.* at 2290.

ARGUMENT

I. WITHOUT MEANINGFUL JUDICIAL OVERSIGHT OF PROPOSED *CY PRES* CLASS-ACTION SETTLEMENTS, CLASS MEMBERS ARE DEPRIVED OF THEIR LEGAL CLAIMS WITHOUT DUE PROCESS

The Fifth Amendment's Due Process clause protects the right of individuals to their liberty and property. Few forms of property are as crucial to a free society as the right to pursue legitimate legal claims, seeking to obtain a redress of wrongs. This right encompasses both the right to bring the claim and, if successful, the right to damages sufficient to make the victim whole. Similarly, while there is no right to counsel in civil litigation, the Court has said that due process includes the right of litigants to have their claims adequately represented by whatever counsel is

bringing claims on their behalf. U.S. Const., amend. V; *Shutts*, 472 U.S. at 812.

The current federal class-action regime raises multiple due-process concerns. First, by their aggregate nature, class actions obscure the individual nature of the rights that justify the legal proceedings. Second, the opt-in mechanism for forming a class involuntarily transfers property from class members and to class counsel, who can then enrich themselves through self-dealing and collusion with defendants. Third, increasingly-common *cy pres* awards are used by class counsel to justify increased fee awards while providing benefit only to class counsel and defendants. *Cy pres* settlements can also appear to corrupt judicial neutrality, if award recipients are chosen with an eye to currying favor with the judges who are tasked with safeguarding the rights of individual class members.

District courts are supposed to protect against deprivation of property by approving "proposals [that] would bind class members" only after determining that a settlement is "fair, reasonable, and adequate." Fed. R. Civ. P. 23(e)(2). Without the bulwark of rigorous scrutiny, class counsel and defendants will feel free to collude to the detriment of individual plaintiffs, whether alone or aggregated in a class.

A. Although treated in the aggregate, the legal claims at issue in class actions are personal and must be protected as individual rights.

The right to pursue legal claims against a defendant is a property right that pertains to each class member, individually. A claim that is successful

yields damages, and those damages are the property right of the victim. Some claims are insufficiently valuable to make them financially viable outside of a class-action context, but the only foundation of a class action is a set of rights that are individual and personal to the class members.

When the class action results in judgment or settlement, each class member has a property right to her share of the damages award. Indeed, once defendant has paid those damages, the victim no longer has a legal right to bring the claims, so the right to seek redress becomes the right to whatever damages the litigation process has determined is necessary to make the victim whole. Notwithstanding the size of the individual class member's share of damages, the right to those damages is a property right that may not be taken from individual class members and given to another without violating due process. Protection of those individual rights is why the Court has held that class members—not "the class"—are entitled to adequate representation in a class action. *Shutts*, 472 U.S. at 812.

Unfortunately, class actions' aggregate nature obscures the individual nature of these rights. By aggregating individual property rights into one lump sum, the personal nature of the right is more easily ignored. If the total settlement is high enough, the requested fee award could be viewed as justified, even if each individual property right is sold for mere pennies on the dollar. The simplicity of the rule makes it appealing, but it obscures whether individual rights are being protected. It also gives perverse incentives

for class counsel to focus on aggregate measures of "success," rather than on whether their clients, individually, are being well-served. Defendants will also concern themselves only with the aggregate view, hoping to settle many claims at a low total cost.

The Court has already held that individual rights to speech and free exercise are not surrendered even when presented in aggregate form. *Citizens United v. FEC*, 558 U.S. 310, 349 (2010); *Burwell v. Hobby Lobby Stores, Inc.*, 134 S.Ct. 2751, 2768 (2014). The individual right to seek redress of wrongs through the courts should be treated in like manner, especially when the threat comes from the right-holders' agent, class counsel.

The dangers of class actions are well known but the benefits to individual class members—having their low-value claims prosecuted—are believed to outweigh those costs. A "rigorous analysis" by courts, *Dukes*, 131 S.Ct. at 2552, is essential to assuring that result, making sure that class members' rights are protected. That rigorous analysis should look askance at the increasingly aggregate nature of class actions: bulk mail distribution of notices to class members; settlements measured in aggregate amounts; reasonableness of attorneys' fees assessed by aggregate and not per-client measures. Some lower courts seem untroubled by these trends and abdicate their responsibility to safeguard individual rights.

B. Present opt-out mechanisms eliminate the most effective method of protecting individual rights.

Erosion of individual rights in class-action

lawsuits is facilitated by opt-out mechanisms for class action formation. In *Shutts*, the Court rejected the claim that only an opt-in system could protect absent class members' Due Process rights, holding that meaningful consent could be obtained through an opt-out mechanism. 472 U.S. at 812. The Court was attentive to individual rights, but the lower courts have often failed to zealously safeguard those rights, resulting in a class-action system without meaningfully consent. Unlike the Kansas opt-out statute praised by the Court in *Shutts*, the process has become entirely "pro forma." *Id.* at 813. Given the incentives facing class members, class counsel, and defendants, this evolution was inevitable.

Having suffered relatively small injuries—or perhaps only de minimis technical "harm" as defined in statute—class members have little incentive to learn of the existence of class actions in which they may have legal interests. Once class counsel assemble their named plaintiffs, there is no incentive to provide meaningful notice to the rest of the class. Why would class counsel want potentially disruptive class members to interfere with their litigation plans, especially if that involves selling off class members' individual rights at pennies on the dollar? Notices are thus likely to resemble little more than the piles of junk mail that most people receive on a daily basis and will be disposed of by class members who are unaware of class action "opportunities" and that they will have forfeited their right to opt out. This is not "consent" in any meaningful sense. *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2071-72 (2013) (Alito, J., concurring) (non-response to class-arbitration opt-out

form is not consent). Class counsel, having engineered a class unable to meaningfully participate, can then treat members' individual rights as bargaining chips in the pursuit of lucrative fee awards.

An opt-in mechanism, by contrast, better secures class members' due process rights by better aligning incentives and reducing opportunities for self-dealing and collusion. First, an opt-in mechanism is voluntary in fact, rather than by presumption, so each class member must choose to employ class counsel to pursue legal claims. Competition among aspiring class counsel would advance class members' interests on price (lower fee award) and quality (better responsiveness, higher damages) dimensions.

Fully participatory class members could then provide meaningful oversight and take whatever actions necessary to protect their own rights. Or, they could acquiesce to the abuses of class counsel and defendants. Either way, they would be exercising their right to choose regarding her claim, a right required by due process, *Richards v. Jefferson County, Ala.*, 517 U.S. 793, 799 (1996) ("the right to be heard ensured by the guarantee of due process has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest").

Thirty-three years ago, when the Court declined to mandate an opt-in mechanism in *Shutts*, 472 U.S. at 812, opt-in costs were much higher, leading to a concern that "[r]equiring a plaintiff to affirmatively request inclusion would . . . impede the prosecution of those class actions involving an aggregation of small

individual claims." *Id.* at 812-13. The Court may also have presumed that good faith and professionalism were sufficient to protect the due process rights of individual class members. The court should reconsider its decision because time has disproven both of those assumptions.

First, technological advances have reduced the transaction costs of obtaining voluntary consent, so that small-value claims can more easily be aggregated through opt-in mechanisms. Second, class actions have become more abusive of individual rights in the years since *Shutts*. Modern class-action lawsuits reduce class members to mere data points, rather than the owners of important rights. Given modern trends in the class-action realm, due process demands an opt-in mechanism and technological innovations have made it feasible to require it.

C. Failure to preserve class members' rights to meaningful participation leads to principal-agent problems and conflicts of interest.

The attorney-client relationship is a classic principal-agent arrangement, subject to the standard dangers that the agent (class counsel) will look out for its own interests, rather than those of the principal (each class member). Due process, professional standards, and economic efficiency all demand that the incentives of class counsel and individual members of the class be aligned, but current practice falls short of that goal. As discussed *supra*, the aggregate nature of class actions and the use of an opt-out mechanism remove class counsel's incentive to

safeguard class members' individual rights. That leaves class members protected only by standards of professional ethics and the judiciary's obligation to safeguard due process rights.

Sadly, as shown by the number of disciplinary actions commenced each month, professional standards are often not enough to assure proper behavior by counsel. Courts can—and should—serve as a bulwark against behavior that deprives class members of their due process rights, but many lower courts have abandoned that responsibility. Class counsel understand that they are essentially unconstrained, and are therefore likely to ignore individual class members and their rights and use the class as an instrumentality in pursuing class counsel's own interests. The Court has previously stated that due process is violated when the named plaintiffs' interests are in line with those of the defendant, rather than the absent class members. *Hansberry v. Lee*, 311 U.S. 32, 45-46 (1940). Self-dealing by class counsel, especially in collusion with defendants, violates the due-process rights of absent class members in precisely the same way.

Self-dealing by class counsel typically takes the form of pursuing a larger fee award. The primary focus when determining the reasonableness of a fee award is the aggregate dollar amount of the settlement; meaningful compensation for class members is secondary, at best. One way that class counsel can inflate fee awards is to be over-inclusive when identifying the class. A larger class means more aggregated damages and, consequently, a larger fee

award. It also means that the individual rights of class members fade further into the background.

The emergence of *cy pres* awards in the class-action context provides circumstantial evidence of this phenomenon. *Cy pres* was initially proposed as a way of disposing of the unclaimed portion of the damages fund. *See generally* Martin H. Redish, Peter Julian & Samantha Zyontz, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617 (2010). Most scholars account for the disparity between awarded and claimed damages by arguing that the damages to be claimed did not justify each class member's cost of obtaining his share. *See id.* It may be, however, that many of those whose alleged injuries went into the damages calculation were not actually harmed but were only included to increase the total size of the class, making their failure to claim damages not only reasonable but ethical.

The incentive to increase the size of the class is also the primary point at which the incentives of class counsel and defendants are aligned with each other and against individual class members. Class counsel want to inflate the size of the class in order to maximize damages awards. Defendants want to inflate the size of the class so that a settlement will eliminate more potential legal claims at a discounted rate. Class counsel can agree to the discount and still increase their payoff due to the increased class size. *See Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 785 (7th Cir. 2004) ("Would it be too cynical to speculate that what may be going on here is that class counsel

wanted a settlement that would give them a generous fee and Fleet wanted a settlement that would extinguish 1.4 million claims against it at no cost to itself?"). Individual class members suffer from this collusion because their injuries are compensated at a discounted rate, to say nothing of those outside of the legitimate class, who suffer because their separate claims have been improperly categorized and disposed of through settlement.

Class counsel are faced with strong incentives to violate the standards of professional ethics, engaging in self-dealing and collusion. If they act on those incentives, they fail to provide adequate representation to absent class members as required by due process. *Shutts*, 472 U.S. at 812. The Court has previously dealt with two such examples of self-dealing by class counsel. In *Dukes*, the Court rejected an attempt to limit damages to back-pay claims in order to make the class action mandatory. *Dukes*, 131 S.Ct. at 2559. The Court rejected this self-interested attempt by class counsel because it would have precluded class members' compensatory damages claim. In *Standard Fire Ins. Co. v. Knowles*, 133 S.Ct. 1345, 1348-49 (2013), class counsel attempted to stipulate to less than $5 million in damages, in order to avoid federal jurisdiction under the Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (2005). While the Court decided that case on other grounds, it acknowledged that the attempted stipulation would have reduced the value of class members' claims. *Knowles*, 133 S.Ct. at 1349.

Lower courts have also rejected selective pleading,

waiver, or abandonment of claims in order to achieve certification of the class, even though doing so would impair class members' ability to raise abandoned claims at a later date. *See, e.g., Arch v. Am. Tobacco Corp., Inc.*, 175 F.R.D. 469, 479-80 (E.D. Pa. 1997); *Pearl v. Allied Corporation*, 102 F.R.D. 921, 922-23 (E.D. Pa. 1984); *Feinstein v. Firestone Tire & Rubber Co.*, 535 F. Supp. 595, 602 (S.D.N.Y. 1982); *Kreuger v. Wyeth, Inc.*, No. 03-cv-2496, 2008 WL 481956, at *2-4 (S.D. Cal. Feb. 19, 2008).

The judiciary must be the final guarantor of individual class members' due process rights, by engaging in a "rigorous analysis" of the plaintiffs' claims. *Dukes*, 131 S.Ct. at 2552 ("Rule 23 does not set forth a mere pleading standard . . . certification is proper only if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied") (internal quotation marks omitted). While the Court in *Dukes* only needed to address the due process requirements of the certification process, due process violations are possible at all points in class-action litigation, and especially in the settlement context. The Court should therefore apply its "rigorous analysis" standard to the entirety of Rule 23.

Some lower courts have declined to engage in the rigorous analysis, presumably because it is difficult or is viewed as an unnecessary intrusion into the results of settlement negotiations between class counsel and defendants. This view is flawed for two reasons. First, Rule 23 provides only a bare-minimum check on abuses by class counsel, and any shortcomings in a

court's analysis leaves individual class members protected only by the good will and ethics of class counsel. It bears asking what other constitutional rights would be considered "protected" with only the good will and ethics of fellow citizens or government agents. Second, a hands-off posture by the courts is inappropriate in a class-action context; given the strong incentives for self-dealing and collusion that class counsel face, any settlement reached is far more likely to preserve class counsel's personal interests than that of the individual class members.

Courts should be aware of the strong potential for self-dealing by class counsel and the general tendency to ignore individual rights, which are the sole basis for the cause of action. Courts must turn a skeptical eye to all settlement agreements and refuse to condone those that appear self-serving or neglect individual class members' interests. Only in that way can courts preserve due process in the class-action context.

D. Use of *cy pres* awards further exacerbates due process concerns.

Any residual chance of maintaining a proper focus on the individual rights of class members is further diminished if *cy pres* awards are introduced. *Cy pres* awards give class counsel and defendants an additional tool for enriching themselves, one that cloaks them a socially-acceptable veneer of philanthropy. And yet, it is philanthropy with someone else's money and obscures the uglier reality that it comes through self-dealing and collusion.

1. Class counsel use *cy pres* to increase their personal take at the expense of class members.

The reasonableness of a requested fee award is typically judged, in large part, on how large it is relative to the total amount gained for the class. Higher fee awards, therefore, require a larger settlement, which can be achieved by increasing either the number of class members or the per-class-member damages. Individual class members receive direct benefit from the latter, so it is preferred. Defendants will prefer the former because it increases the number of potential legal claims disposed of and reduces the risk of future litigation. Either one will benefit class counsel, but class counsel will have strong incentives to align with defendants and choose the former, as a way of facilitating a settlement and an agreement not to oppose the fee request.

At best, this is class counsel pursuing self-interest instead of that of individual class members whose claims, it must be remembered, have been involuntarily commandeered by counsel. At worst, class counsel and defendants will further collude, discounting each class member's individual claim and further expand the class in order to achieve a high fee award and manage defendant's litigation risk.

This is a standard due process risk from class actions, and trial courts must be alert in order to identify and reject settlements exhibiting signs of this type of self-dealing. *Cy pres* awards go one step further, providing class counsel with an additional form of compensation that falls outside the fee award

process and can easily avoid scrutiny. In addition to whatever effect *cy pres* awards have on total settlement value and, consequently, the fee award, they also allow class counsel to effectively send a sizeable check to a charitable organization. In other words, *cy pres* awards supplement class counsel's normal compensation with the praise—and corresponding public relations benefits—they receive for their benevolence to a charity.

The use of *cy pres* awards also offers administrative benefits to class counsel, bypassing the sometimes complicated determination of how to process damages payments to class members. By reducing costs while maintaining the same settlement amount, class counsel increases the net payout to themselves. As a foundational matter, then, class counsel prefer *cy pres* awards because total compensation is raised in ways that are hidden from view, but in ways that relieve them of their fiduciary responsibility of safeguarding the rights of each individual in the class.

This case exhibits a classic example of the type of self-dealing that arises with the use of *cy pres* awards—choosing award recipients that have direct ties to class counsel. Three of the *cy pres* recipients are the alma maters of class counsel, a fact dismissed out-of-hand by the Ninth Circuit in violation of its own precedent and common sense about the "nascent dangers" of the practice. *In re Google Referrer Header Privacy Litigation*, 869 F.3d 737, 749-50 (9th Cir. 2017) (Wallace, J., concurring in part and dissenting in part). If the proposed *cy pres* award is approved,

class counsel will surely receive a benefit above and beyond the already-high fee award, particularly if class counsel regularly donate to their alma maters, as the *cy pres* award likely covers their charitable giving for some years to come.

This case demonstrates that many lower courts refuse to police self-dealing in the class-action context. If the Court sanctions this *cy pres*-only settlement, it will lead to more brazen self-dealing in the future, as it is unlikely that lower courts will suddenly rediscover their fidelity to due process. The Court should make clear that *cy pres* deprives individual class members of their property without due process.

2. Defendants use *cy pres* to lower the overall cost of any settlement.

Defendants face strong incentives to collude with class counsel and against the class as a general rule, but particularly when *cy pres* awards are used. As discussed *supra*, defendants would prefer—given that the lawsuit has already commenced—to expand the class in order to dispose of as many claims as possible, especially if class counsel agree to heavily discount each class member's damages. When *cy pres* awards are in play, the incentives for collusion are even stronger, as defendant can help choose the award recipients in a way that maximizes the public relations benefit. The defendant—accused of inflicting harm on a high number of plaintiffs—can lessen any public relations harm from the lawsuit by casting itself as the source of funds to charitable organizations. *See SEC v. Bear, Stearns & Co. Inc.*, 626 F. Supp. 2d 402, 415 (S.D.N.Y. 2009) ("In general,

defendants reap goodwill from the donation of monies to a good cause.")

In other words, defendant burnishes its philanthropic credentials using individual class members' property. This is a perverse reversal of the traditional workings of the judicial system, where plaintiffs are supposed to *receive* funds from a defendant who has wronged them. Additionally, if class counsel is willing to go along, "defendants may also channel money into causes and organizations in which they already have an interest." *Id.* Rather than donate its own funds, defendant spends class members' funds, using the court and the settlement agreement as an intermediary. In an extreme case, total philanthropic donations by defendant might remain constant, meaning the settlement costs the defendant nothing. Here, defendant and class counsel appear to have engaged in precisely this type of collusion, as defendant has a pre-existing relationship with four of the recipient organizations.

Cy pres awards reduce the cost to the defendant of settling. There is nothing inherently wrong with defendant negotiating a lower-cost settlement amount, if doing so facilitates a resolution that improves the position of the individual class members. In the case of a *cy pres* settlement, however, class members receive nothing in exchange for the benefits to defendant and class counsel.

3. *Cy pres* erodes judges' neutrality through awards that benefit them.

As troubling as self-dealing and collusion are, even worse is the potential for outright corruption of the

judicial process. Class counsel have a strong incentive to attempt to subvert the neutrality of judges by choosing *cy pres* award recipients with ties to the trial judge, nudging the judge to approve the settlement. In *Fairchild v. AOL*, LLC, No. CV09-03568 CAS (PLAx) (C.D. Cal. 2009) (class action settlement agreement), for example, the *cy pres* award included payment to the Legal Aid Foundation of Los Angeles, a charity on whose board the trial judge's husband sat. Such an award might normally be a great benefit to society, but "the specter of judges and outside entities dealing in the distribution and solicitation of large sums of money creates an appearance of impropriety." *Bear Stearns*, 626 F. Supp. 2d at 415. In other contexts, this strong interest by the judge in the outcome could be cause for mandatory recusal. *See Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 876 (2009) ("[T]he Due Process Clause incorporated the common-law rule that a judge must recuse himself when he has 'a direct, personal, substantial, pecuniary interest' in a case. This rule reflects the maxim that '[n]o man is allowed to be a judge in his own cause; because his interest would certainly bias his judgment, and, not improbably, corrupt his integrity.'") (quoting *Tumey v. Ohio*, 273 U.S. 510, 523 (1948); The Federalist No. 10). This due-process concern typically arises in the context of settlement approval, however, so the defendant has already approved and will not challenge the settlement. If the trial court fails to engage in a rigorous analysis, as was the case here, absent class members' rights will go unprotected in yet another way.

4. *Cy pres* settlements benefit many parties, but provide nothing to individual class members, the owners of the claims.

Class action lawsuits are often defended because, notwithstanding the perverse incentives inherent in the aggregate nature of the system, they are necessary to make good on the promise of justice to aggrieved class members. Unfortunately, our system falls short of that ideal, with many class members receiving pennies on the dollar, if anything. The claims process is often set up in a way that virtually guarantees a low percentage of class members will obtain any relief. *Sullivan v. DB Investments*, 667 F.3d 273, 329 n.60 (3d Cir. 2011) (en banc) (finding that response rates "rarely exceed seven percent"); *Gascho v. Global Fitness Holdings, LLC*, 822 F.3d 269, 296 (6th Cir. 2016) (Clay, J., dissenting) ("the median response rate in a study of consumer class actions was 5-8%"). In other cases, the settlement includes only coupons for the discounted future purchase of goods from the defendant who has wronged the individual class members. The risk of due process violations are why the Court has mandated that lower courts engage in rigorous analysis to assure that any settlement is fair, reasonable, and adequate.

All concerns about shortchanging individual class members are heightened in the context of a *cy pres* settlement because the value of class members' claims is given to charitable organizations, rather than to the owners of the claims. In a very real sense, class members—whose claims provide the *only* justification

for the entire proceeding—are the only ones who receive nothing as their claims are sold. Class counsel use the claims to justify higher fees. Defendants receive a discounted cost of settlement. All litigation participants, save the claims' owners, are praised for their role in generating extra funding for charities. Even society potentially receives some additional deterrence benefit, but individual class members *qua* class members, receive nothing. "There is no indirect benefit to the class from the defendant's giving the money to someone else." *Mirfasihi*, 356 F.3d at 784.

The substitution of *cy pres* for actual compensation to class members calls into question the raison d'être of class action lawsuits. "A consumer class action is superior to individual suits because it allows people with claims worth too little to justify individual suits-so called negative-value claims-to obtain the redress the law provides. But if the consumer class action is likely to provide those with individual claims no redress . . . the consumer class action is likely not superior to individual suits." *Hoffer v. Landmark Chevrolet Ltd.*, 245 F.R.D. 588, 603 (S.D. Tex. 2007).

5. *Cy pres* awards are never the only option available to resolve a class action.

Cy pres awards are not simply inappropriate in this case but in every case; there are no circumstances under which *cy pres* awards are the only option. Indeed, our judiciary functioned well enough for most of its history without needing to resort to *cy pres* awards, and it is peculiar that they would gain popularity with class counsel in an era of advancing

technology—with corresponding reduction in the cost of notifying and facilitating disbursement to the class. Peculiar, but not surprising, given the ability of class counsel and defendants to use *cy pres* awards for self-enrichment at the expense of class members.

The Ninth Circuit, below, approved a *cy pres* only settlement because the settlement fund was "non-distributable." *In re Google*, 869 F.3d at 742. The reason it was non-distributable, however, is that class counsel and defendants agreed to a small enough settlement amount, returning "a paltry 4 cents in recovery." *Id.* If affirmed, this would set a troubling precedent, that class counsel and defendant need only discount class members' individual claims even more if they want certainty that their *cy pres* settlement will be approved. More importantly, however, the Ninth Circuit also hinted that the claims which formed the foundation of the class action were likely frivolous. *Id.* Most class actions that are "non-distributable" likely fall into the same category, with non-existent harms that naturally yield de minimis damages (although any number of non-frivolous claims might be included in an expanded class, as described *supra*, in order to eliminate real legal liability at frivolous prices). Rather than invite a degradation of due process by sanctioning a *cy pres* settlement, a court could dismiss the class action as, indeed, the District Court attempted to do twice.

It is worth mentioning that *cy pres* only settlements, while increasing in frequency, are still the minority of class action settlements where a *cy pres* award is used. More common are those in which

disbursement to the class is attempted, but any unclaimed funds are distributed to charitable organizations. The dangers of self-dealing and collusion are still present, however, because most claim rates are already low, and class counsel and defendants can easily guarantee that number remains low—so most of the fund remains and they can obtain nearly all the benefits of a *cy pres*-only settlement.

The Court should recognize the wide range of available alternatives and reject the use of *cy pres* awards in the class-action context.

E. Class Actions Have Become a Haven for Judicial Rent-Seeking, Posing a Significant Threat to the Rule of Law

Lobbying for special benefits—known as "rent-seeking" to public choice economists—has plagued the executive and legislative branches for some time. The Court faced an example of administrative rent-seeking in *N.C. State Bd. of Dental Examiners v. FTC*, 135 S.Ct. 1101 (2015), in which the Court rejected North Carolina's attempt to shield the Board's decisions from antitrust scrutiny because the Board was made up of "market participants" who stood to gain from the decisions they made. *Id.* at 1114. *See also St. Joseph Abbey v. Castille*, 712 F.3d 215, 226 (5th Cir. 2013) (rejecting a state regulation restricting sale of caskets as rent-seeking by market participants who could charge higher prices). The Court has also rejected a form of judicial rent-seeking, in mandating recusal of a state Supreme Court Justice whose main campaign contributor had a case pending before the state Supreme Court. *Caperton*, 556 U.S. at 876.

Our class action system is rife with opportunities to rent-seek, all of which act to the detriment of those who come before the courts of the United States and the individual States, seeking redress. Class counsel and defendants seek benefits (rents) for themselves, and they will seek out courts most likely to reward them. They will also seek out tools that increase their chances of obtaining the special favors they seek. *Cy pres* awards are the perfect rent-seeking vehicle for class counsel and defendants, as it both increases the total return they can obtain as well as masks their rent-seeking in a cloak of philanthropy. But, it does so at the expense of individual class members and due process and, potentially, at a cost of subverting judicial neutrality. The Court should therefore reject this expansion of judicial rent-seeking and prohibit the use of *cy pres* awards in class actions.

The Court should also begin to curb judicial rent-seeking throughout the class action system, by enforcing the Court's previous mandate of a "rigorous analysis," *Dukes*, 131 S.Ct. at 2552, for the entirety of Rule 23.

F. The Ninth Circuit's Abuse of Due Process in Class Actions Must Be Curbed to Protect Due Process Nationwide

The requirements of Rule 23 are easily understood, and the Ninth Circuit acknowledged its responsibilities, *In re Google*, 869 F.3d at 741 ("we scrutinize the proceedings to discern whether the [lower] court sufficiently 'account[ed] for the possibility that class representatives and their counsel have sacrificed the interests of absent class

members for their own benefit"), 742 ("we benchmark whether the district court discharged its obligation to assure that the settlement is 'fair, adequate, and free from collusion.'"), but without once mentioning the requirement of a "rigorous analysis." That fact is unsurprising, given the Ninth Circuit's previous abuse of due process in the class-action context. *Lane v. Facebook, Inc.*, 696 F.3d 811, 821 (9th Cir. 2012) (refusing to inquire rigorously into an abusive settlement because to do so would be "an intrusion into the private parties' negotiations [that] would be improper and disruptive to the settlement process.")

Here, the Ninth Circuit maintained its perverse standard by "quickly dispos[ing]" of claims that a *cy pres* only settlement appropriated the class members' legal claims for the personal benefit of class counsel and defendant, *In re Google*, 869 F.3d at 741, failing to uphold the due process rights of individual class members. The Ninth Circuit has shown an unwillingness to acknowledge the due process risks of class actions generally, and the particular dangers of collusion present when *cy pres* awards are used. The Ninth Circuit did acknowledge that "*cy pres* only settlements are considered the exception, not the rule," *id.*, but still approved the settlement in cursory fashion merely because the district court had found the settlement fund to be non-distributable. *Id.* By so doing, the Ninth Circuit failed in its review responsibilities and established a troubling precedent that will encourage class counsel and defendants to both maximize class size and reduce per-member compensation. As long as the per-member amount is low enough, the Ninth Circuit has effectively declared,

cy pres only settlements will be approved "quickly" and without meaningful review. This will result in wholesale deprivation of those members whose claims should not have been included but were, as well as those whose claims should have been included but will have been heavily discounted.

The Ninth Circuit correctly articulated the fundamental risk associated with using *cy pres* awards—the process of selecting award recipients might "answer to the whims and self-interests of the parties, their counsel, or the court." *Id.* at 743 (citing *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1038-39 (9th Cir. 2011)). Once again, however, what began in promising fashion degraded rapidly. The Ninth Circuit never engaged in a rigorous analysis, failing to uphold due process or even circuit precedent requiring a "higher level of scrutiny for evidence of collusion or other conflicts of interest." *Id.* at 749 (Wallace, J., concurring in part and dissenting in part) (citing *In re Bluetooth Headset Prod. Liab. Litig.*, 654 F.3d 935, 946 (9th Cir. 2011).) This, even after acknowledging that "the district court cannot as effectively monitor for collusion and other abuses." *Id.* at 741. To summarize, even though the Ninth Circuit knew that collusion was more likely in this case, that the district court was ill-equipped to prevent collusion, and that prevention of collusion was a fundamental responsibility, it refused to look for collusion.

Evidence of collusion was apparent to any good faith examination, but the Ninth Circuit chose to remain ignorant of it. As approved by the district court, the settlement transferred the value of

individual class members' claims to class counsel's alma maters and four previous recipients of defendant's charitable largesse. This type of self-interested and collusive behavior had previously been described by the Ninth Circuit as "unseemly," *Nachshin*, 663 F.3d at 1039, but was accepted in this case without a moment's hesitation. The reason? It wasn't as bad as the *cy pres* award in *Lane*, where the class members' property was handed over to an entity controlled by defendant. *Lane*, 696 F.3d at 817. Compared to that appalling approval of naked self-dealing by—and collusion between—class counsel and a defendant, almost anything would appear mild, but such a cursory reference hardly satisfies the due process to which class members are entitled.

The precedent established by the Ninth Circuit in *Lane*, and expanded in this case, will lead to ever increasing levels of self-dealing by class counsel, greater levels of collusion between class counsel and defendants, and greater rent-seeking pressures on judges to corrupt their rulings for personal gain. If district courts in the Ninth Circuit are freed from their responsibility to police self-dealing and collusion, there will be no more due process for individual class members, who will see their property handed over to whomever offers class counsel and defendants the best return. Given the national nature of class actions, class members nationwide will soon suffer the same deprivations of due process, as class counsel will choose to file in the Ninth Circuit, where their self-dealing and collusion will receive minimal-to-no scrutiny. Only the Court can stop this dangerous trend.

II. USE OF *CY PRES* AWARDS IN CLASS-ACTION SETTLEMENTS COMPELS CLASS MEMBERS TO SUPPORT SPEECH WITH WHICH THEY MAY DISAGREE, IN VIOLATION OF THE FIRST AMENDMENT

When a class action is settled, the damages funds represents the value of the claims of the individual class members, and the class members each own a portion of the award. *Klier v. Elf Atochem N. America, Inc.*, 658 F.3d 468, 474 (5th Cir. 2011). Anything short of a direct transfer of those funds to class members, therefore, is a diversion of property from its rightful owners. Some transfers of this type—reasonable attorney fees and court costs, for example—may be justified as the costs of transforming an intangible property interest into spendable funds. When a court approves a *cy pres* award, however, it gives class members' property to a charity without the meaningful consent of those who own the funds. That organization will then use the funds provided by the settlement agreement to pursue its own goals, including (understandably) by engaging in various forms of speech. Individual class members have no way to abstain from funding that speech, so courts in effect compel them to speak in the voice of those charitable organizations. *See Knox*, 132 S. Ct. at 2289 ("Closely related to compelled speech . . . is compelled funding of other private speakers or groups.").

This type of *cy pres* imprimatur is problematic because the Court has held that the government "may not . . . compel the endorsement of ideas that it approves." *Knox*, 132 S. Ct. at 2288. "First

Amendment values are at serious risk if the government can compel a particular citizen, or a discrete group of citizens, to pay special subsidies for speech on the side that it favors." *United States v. United Foods, Inc.*, 533 U.S. 405, 411 (2001). *See also Janus v. Am. Fed. of State, County, and Municipal Emp. Council*, 585 U.S. ___ (2018) (16-1466) (slip op. at 8) ("Compelling individuals to mouth support for views they find objectionable violates that cardinal constitutional command [that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion].").

Only a narrow class of speech can be compelled without violating the First Amendment: mandated association among a defined group as part of a comprehensive regulatory scheme, and then only if the required contributions are for the benefit of the association. *United Foods, Inc.*, 533 U.S. at 411-14. And even then, the contribution can only be sustained insofar as it is "a necessary incident of the larger regulatory purpose which justified the required association." *Id.* at 414. (discussing *Keller v. State Bar of California*, 496 U.S. 1 (1990)).

There is no part of a *cy pres*-only settlement that meets the *United Foods* test. Class actions arise from a myriad of state and federal laws, not a comprehensive regulatory scheme. The only uniform rules for class actions in federal court are procedural—Rule 23—not substantive. Likewise, association among class members is voluntary, even if not based on full and meaningful consent.

The Court has also expressed doubts about the use of opt-out systems given compulsory subsidies. *See Knox*, 132 S. Ct. at 2290-96. While there are significant differences between the context here and that of *Knox*, certain principles are the same, such as that courts "do not presume acquiescence in the loss of fundamental rights." *Id.* at 2290. "Once it is recognized, as our cases have, that a nonmember cannot be forced to fund a union's political or ideological activities, what is the justification for putting the burden on the nonmember to opt out of making such a payment?" *Id.* Similarly, class members should not be forced to subsidize class counsel's, defendants', or the judges' charitable goals.

Whether or not an opt-out mechanism is proper for a traditional class action, once a *cy pres* award is introduced, an opt-in mechanism is needed because courts can no longer presume acquiescence by class members in the loss of their First Amendment rights.

A. Class Members Are Likely to Be Diverse in Their Political and Social Views, while *Cy Pres* Award Recipients Are Likely to Share the Views of Class Counsel, Defendants, and the Court

In order for a class action to be certified, the class has to be "so numerous that the joinder of all members is impracticable." Fed. R. Civ. P. 23(a)(1). The only required commonality between members of the class pertains to their legal claims, not their personal preferences, or political persuasion. It would therefore be truly extraordinary if members of the class were uniform in their preferences for charitable giving,

especially in a class as large as this one, where nearly half the U.S. population is involved. To take an obvious example, it is quite likely that half the class voted for Donald Trump and half for Hillary Clinton in the last presidential election. Likewise, there are likely significant differences of opinion in a class so large regarding appropriate internet privacy policy.

In light of the certain diversity of views among class members, it is inappropriate for class counsel and defendants to presume to select a "worthy" charities to be the recipients of funds that represent damages owed to class members. This is particularly true in light of the strong incentive for class counsel and defendant to choose *cy pres* recipients that fit their preferences, rather than the indeterminable preferences of class members.

That a trial or appellate court sanctions the choice is immaterial to the question of class members' First Amendment rights to be free from compelled speech. Such a government imprimatur does not render the nature of the speech voluntary.

B. If *Cy Pres* Funds Are at All Controlled by Defendants, Class Members Will Be Forced to Support the Views of the Those Who Caused Their Injury, and May Even Be Compelled to Support a Repetition of the Actions That Resulted in That Injury

One thing that class members must have in common is an injury caused by the defendant. Fed. R. Civ. P. 23(a)(3); *Comcast Corp. v. Behrend*, 133 S. Ct. 1426, 1432 (2013). The result of a fair and just trial should be a transfer of wealth from perpetrator to

victim, not the other way around. As a result of the settlement, the defendant admits—impliedly or explicitly—that the victims have a legal right to restitution. To compel the class members to, in effect, further the views and interests of the party that injured them is repugnant to basic principles of justice and fairness and is a particularly pernicious example of Thomas Jefferson's adage that "to compel a man to furnish contributions of money for the propagation of opinions which he disbelieves, is sinful and tyrannical." Irving Brant, James Madison: The Nationalist 354 (1948) (quoted by *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209, 235 n.31 (1977)).

To add insult to injury—quite literally—the money that should have made the class members whole is, instead, used to burnish the image of the one who inflicted the damages that gave rise to the lawsuit.

From a more practical perspective, if the defendant is thus rewarded for its role in damaging class members, it will feel less reluctance to engage in future activities in the same vein, creating the perverse possibility that the class members will be forced to fund their future, repetitive victimization. This peculiar form of unconstitutional compelled speech can be avoided if courts fulfill their responsibilities under Rule 23, for it cannot be argued that forcing victims to fund their victimizers is fair, reasonable, or adequate.

The use of *cy pres* awards in class action settlements, particularly those that enable the defendant to control the funds, are an emerging trend, one to which courts must attend in order to preserve

the due-process and free-speech rights of class members. Rule 23's "rigorous analysis" requirements should be enforced.

CONCLUSION

The use of *cy pres* in class-action settlements, particularly those that enable the defendant to control the funds, are an emerging trend to which courts must attend in order to preserve the due-process and free-speech rights of class members. If not prevented by proper application of Rule 23's rigorous analysis requirements, class counsel, defendants, and judges benefit at great cost to absent class members.

The Court should reverse the court below.

Respectfully submitted,

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